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JUNE 1988

FOREST INDUSTRIES

LOGGING/PULPWOOD/FORESTRY/LUMBER/PANELS

Loader swings logs to road in series of 80-foot arcs

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INDUSTRY NEWS

Interest rates: a nudge here and a tickle there

WASHINGTON, D.C.—Economic storm clouds were gathering on the horizon at press time. Whether they represent a brief spring squall or a serious rainy season is yet to be seen.

In early May, the Federal Reserve apparently made some adjustments to the big money machine, causing a ripple of fear that credit would be tightened. This bumped a key banking interest rate slightly, and occurred just after economists at a housing conference in Washington suggested home mortgage interest rates would rise significantly by the end of the year.

The Fed is expected to keep a light hand on the reins, however, both because this is an election year and because a discount rate increase last September shared some of the blame for the October stock market collapse.

Bond dealers detected Federal Reserve action May 9 when the central bank put fewer reserves into the banking system than were expected. This moved the sensitive federal funds rate, which banks charge one another for overnight cash reserves, beyond 7% from a previous 6.75%.

This in turn opened the possibility that the prime rate could rise a quarter of one percent to 8.75%, according to some observers.

An annual conference conducted by the National Assn. of Home Builders produced a near-consensus that interest on 30-year, fixed-rate mortgages would reach 11% by the end of the year. David Seiders, NAHB chief economist, put the figure at 11.5%.

Since early spring, mortgage rates have risen from 9.5% to almost 10.5% nationally.

Projections of housing starts for the year remain clustered around 1.50 to 1.55 million, with a booming business in single-family dwellings offsetting a soft multi-family market.

Meanwhile, U.S. Commerce Department figures show housing starts inched upward 1.9% in March to a seasonally adjusted annual rate of 1,543,000.

The February rate was revised upward to 1,514,000.

The March figure was 10.4% lower than the rate in March 1987.

Single-family starts increased 7.1% in March; multi-family units dropped 12.2%, both on an annual rate basis.

The annual rate for building permits issued in March was 1,452,000, up 2.1% from February. ■

MILL PROJECTS

Improved board surface suitable for overlays

VAL D'OR, QUE.—The Forpan Inc. particleboard plant will undergo a C$20-million modernization which will begin this year. The announcement came from Rudolf Kunz, president and CEO of the West Germany-based Kunz Group, majority owners of Forpan's parent company, Uniboard Canada.

Process changes will improve surface characteristics of the board to make it an attractive substrate for the new generation of film overlay materials.

Chapleau sawmill to grow

Chapleau Forest Products Ltd., Chapleau, Ont., is the beneficiary of a C$16-million modernization and expansion investment by its parent company, Green Forest Lumber Corp. of Toronto. The project, involving the sawmill and planing mill, will start this summer and is targeted for completion by April 1989.

Grondin mill to rebuild

The Irenee Grondin et Fils Ltée white pine sawmill at St. Zacharie de Beauce, Que., destroyed by fire last year, will be rebuilt at an estimated cost of C$1.9 million. ■

QUARTERLY REPORTS

Pulp, paper strength pulls earnings upward

SAN FRANCISCO, CALIF.—Strong markets for pulp and paper products carried integrated forest products corporations through a healthy first quarter, with financial reports showing strong gains in sales and earnings.

The solid-wood story had less to recommend it. Where identified separately, most building material operations were down from first-quarter 1987—some a little, some a lot.

Of course, for every rule, there's an exception. Moving against this trend, Louisiana-Pacific Corp. building products sales for the quarter were up 13% to $401.6 million and operating profit was up 9% to $41.8 million, contributing to the company's best first quarter on record.

Potlatch Corp. wood products group earnings of $0.7 million represented a drop of 89% from the comparable quarter's income last year of $6.3 million. Chairman and CEO Richard B. Madden attributed the decrease to startup

expenses at a new sawmill in Lewiston, Idaho, reduced lumber shipments and lower income from the company's *Oxboard* oriented strand board.

Once startup costs are absorbed, the efficient new sawmill should start generating profits, Madden said.

WTD Industries recorded a sharp drop in earnings for the quarter, compared with first-quarter 1987, despite a 66% gain in sales.

This drop was due largely to a temporary shortage of logs at several locations coupled with high log prices, explained president Bruce L. Engel.

The combination of forest closures last fall due to fire and extreme ice and snow conditions in December and January is unlikely to repeat itself, Engel declared.

Temple-Inland Inc.'s building products operations earned $7.1 million in the first quarter, against $9.6 million in the same period a year ago. This drop of 26% was centered in products depending on residential construction.

Products with non-residential uses, such as particleboard for furniture and cabinet markets and lumber supplied to the treating industry, continued strong, according to president and CEO Clifford J. Grum.

Georgia-Pacific Corp. building products profits dropped 9.2% from $119 million in first-quarter 1987 to $108 million this year. Chairman and CEO T. Marshall Hahn Jr. attributed the decline "in part to a fall-off in demand for gypsum products and to the effect of bad weather on housing starts. Good demand from home improvement and industrial markets, however, lessened the impact of the drop in housing," Hahn said.

While Boise Cascade Corp. was setting a new net income record in the first quarter, its building products segment was stalled in a holding pattern. Sales, at $225.6 million, were down 7% and earnings of $21.4 million were close to flat at a 1.8% drop.

"Despite a drop in housing starts from year-ago levels, the performance of this business continues to be aided by robust repair-and-remodel and international markets," noted chairman and CEO John B. Fery.

Willamette Industries Inc.'s report noted that building materials profits were "substantially lower" than last time, but "are showing unexpected strength in the face of pessimistic housing forecasts." ■

U.S., Canadian forest industry results, first quarter 1988 ($ millions)

Company	Sales	% change 1988/87	Earnings[1]	% change 1988/87
Abitibi-Price	C800.0	15.0	C44.1	101.4
Boise Cascade Corp.	1,016.3	11.4	66.5	70.7
B.C. Forest Products	C356.0	6.0	C45.4	38.8
Canfor Corp.	C295.1	9.1	C29.0	40.1
Champion International	1,266.1	15.4	102.0	83.8
Chesapeake Corp.	161.3	3.8	9.9	133.9
Consolidated-Bathurst	C582.6	9.3	C53.1	60.9
Domtar Inc.	C673.0	11.4	C37.0	(15.9)
Federal Paper Board	245.5	6.8	21.9	100.6
Georgia-Pacific Corp.	2,115.0	14.0	106.0[2]	32.5
Great Lakes For. Prods.	C209.0	14.2	C33.5	70.4
Great Northern Nekoosa	843.9	46.9	78.3	80.6
International Paper Co.	2,300.0	27.8	159.0[3]	76.7
Louisiana-Pacific Corp.	483.0	14.2	30.6[4]	89.0
MacMillan Bloedel Ltd.	C796.5	10.7	C91.6	51.7
Noranda	C1,075.0	6.1	C62.9	49.1
Pope & Talbot Inc.	115.7	15.4	8.0	19.6
Potlatch Corp.	258.2	3.9	26.5	49.0
Scott Paper Co.	1,126.4	17.7	74.0	51.0
Stone Container Corp.	881.3	50.4	65.3	150.2
Temple-Inland Inc.	425.7	9.0	45.6	35.3
Union Camp Corp.	645.4	18.6	67.5	52.6
Weldwood of Canada Ltd.	C209.9	16.0	C15.5	20.6
West Fraser	C102.0	10.0	C11.1	(7.5)
Westvaco Corp. (1/31)	501.3	13.7	37.6	93.1
Weyerhaeuser Co.	1,855.5	14.7	114.2	12.0
Willamette Industries	404.8	25.3	40.4	76.0
WTD Industries (1/31)	60.3	66.1	0.2	(79.5)

1. Income after taxes from continuing operations, excluding most significant non-recurring items in both years. 2. 1987 quarter excluded $6-million pretax gain from liquidation of investments. 3. 1987 quarter includes $14-million pretax gain from sale of securities. 4. 1988 quarter excludes nonrecurring gains of $146 million from settlement of timberlands dispute and $15.7 million from sale of Container Products Division, Fibreboard Corp.

EAST MEETS WEST

CP merging companies into Canadian giant

MONTREAL, QUE.—Steps are being taken to merge Great Lakes Forest Products Ltd. and CIP Inc., forming a new company to be known as Canadian Pacific Forest Products Ltd.

CIP is a wholly owned subsidiary of Canadian Pacific Ltd., which also holds a 54.3% interest in Great Lakes. The merger has been approved by CP and CIP directors and by a committee of Great Lakes directors. The Great Lakes board and shareholders were scheduled to vote June 2. The new firm, owned 79.7% by Canadian Pacific, would be the second largest market pulp and newsprint producer in North America.

Solid-wood operations of both companies to be merged are smaller in scale: CIP produces about 250 million bd ft of lumber annually at sawmills in Ladysmith and Tahsis, B.C.; while Great Lakes produces about 130 million bd ft of lumber per year at Dryden and Thunder Bay, Ont.

Hardwood mills sold

Timber Products Co. L.P., Springfield, Ore., has purchased the Cliffs Forest Products Co. hardwood sawmill and veneer plant in Munising, Mich., from Cleveland-Cliffs Inc. This leaves Cleveland-Cliffs with 310,000 acres of timberlands on Michigan's Upper Peninsula which it will sell later.

Fletcher resting in B.C.

Fletcher Challenge Ltd. CEO Hugh Fletcher has said his company would not immediately seek to expand its ownership in British Columbia Forest Products Ltd. Fletcher Challenge holds a 69% stake in BCFP and 100% ownership of Crown Forest Industries Ltd. ■

Changing trade rules in the European Community should help improve the ability of North American wood products producers to serve the market

World timber markets reviewed at conference

London, England

The themes were familiar: economic trends; American economic policy; increased efficiency and value-added processing; changing supply sources; new rules and product standards.

But the location was London's Royal Garden Hotel, and the subject was world lumber markets in relation to the United Kingdom. At Timber Trading 88, the fifth in an annual series put on by *Timber Trade Journal*, some 190 people heard experts outline emerging trends for both softwoods and hardwoods.

By Lloyd C. Irland

TABLE 1—Manufacturing productivity growth output per worker, annual percentage increase

Nation	1964-73	1973-79	1979-87
United States	3.6	2.4	3.2
Japan	9.9	5.7	3.2
West Germany	5.7	4.2	2.1
United Kingdom	4.0	0.7	3.6

SOURCE: The Henley Centre for Forecasting

Considering North America's strong softwood export performance in 1987 and the improved orientation toward world trade that is beginning to be felt in the U.S. industry, the observations at this conference should be of wide interest.

A strong U.K. economy

Analyst Eric Salama of the Henley Centre for Forecasting offered an upbeat review of the recent performance of the economy in the United Kingdom.

He suggested that the U.K. is in better shape than it has been for 15 years, measured by developments in technology, investment, profits, and labor costs and productivity. He noted that the U.K. depends more heavily on exports than does Japan. As one example, manufacturing productivity growth has improved significantly in the U.K. in recent years, leading other major industrial nations (Table 1).

The Thatcher government's supply-side policies and efforts to trim government spending and taxes were credited for much of this improvement.

Robert Erith of SCBI Savory Milln Ltd., predicted that for 1988 the British federal net borrowing requirement could be zero for the first time in years, even with a tax cut. He noted the U.K. has significantly increased its net asset position overseas during these years.

American policy

Salama noted that "the three Ds"—deficits, the dollar and debt—were the significant hazards to continued growth for the U.K.

The role of American policy, especially concerning the "Twin Deficits" in U.S. trade and federal finances, were major uncertainties: the resolution of those issues will affect the third one—the value of the dollar.

Salama said he hoped the U.S. would somehow muddle through these problems, as it has in the past. All concerned with foreign trade are watching U.S. policy on protectionism, as well as the campaign rhetoric of the various presidential candidates.

U.S. policy came in for a blasting from Adam Zimmerman, chairman of Noranda Forest Inc. Zimmerman described the U.S. softwood industry's trade actions against Canadian softwood as "well-planned and harmonized aggression."

He argued that "replacement" of the 15% export levy by stumpage increases would damage Canadian competitiveness in world markets and would before long have to be revised, because "you can't get blood out of a stone." He did suggest that there may be positive results if the U.S.-Canadian Trade pact is ratified, though it would lead to some restructuring.

U.K. timber market outlook

U.K. housing production has been at a high level in recent years, on a similar trend to the U.S. At the same time, government involvement in housing production declined significantly.

The repair, maintenance and improvement (RMI) market is very strong as homeownership rises and as buildings age. Given the extraordinary cost of housing in Britain, more emphasis on RMI is expected.

The market share of timber-frame housing has fallen steeply in recent years. For 1988, a modest decline in housing construction is expected, but RMI and non-residential construction are expected to maintain strength in timber demand.

Imports of softwood timber rose 9% in 1986, 7% in 1987, and are expected to remain stable in 1988. Import prices for softwood are expected to rise about 5% in 1988.

Erith noted that London has looked more favorably on timber stocks in recent years, in the wake of improved management, consolidations and strong construction demand. He said he expects the coming U.K. federal budget to contain further individual income tax cuts.

But, ominously for private forestry, Erith said he sees a possibility that income tax provisions favorable to forestry will be considered for reduction or elimination. Those provisions have been the subject of intense criticism from both financial experts and environmentalist groups.

In so many ways, events in the U.K. bear an eerie similarity to our recent American experience.

Excellence in management

A major theme of the conference was rationalization, quality and value-added—in short, modern excellence in management.

Patric Fredell of the Swedish Wood Exporters Assn. noted that sawmills in Finland and Sweden, losing money in recent years, have trimmed capacity and improved productivity. They are now emphasizing improved drying and supplying value-added components to their customers.

Zimmerman noted that Noranda achieved a 30% cut in conversion costs in 1982-85. Noranda is no longer "content to supply generic rough green" lumber. The company is boosting Research & Development outlays, believing that it is getting a 30% return on such expenditures.

Zimmerman pointed to MacMillan Bloedel's new reconstituted product, Parallam, as an example of a promising new technology.

The distribution system also was mentioned as a target for rationalization. Large shippers to Europe have been frustrated by what Zimmerman called "the arcane web of sales relationships."

There will undoubtedly be further rationalization in the marketing system as large shippers endeavor to get closer to customers and to sell value-added products in volume.

All the same, Fredell assured listeners that the Swedes, while they wish to upgrade product lines, have no wish to "sell down the line," going around traditional channels.

British buyers have been concerned about the declining quality due to smaller trees and more remote timber sources in their traditional supplying nations. Many dimensions of quality have given rise to concern, including defects due to improper drying, scantness and wane, and knottiness.

Clearly, selling on quality is becoming more important then ever before, in a market that is already demanding in its quality specifications. A quick glance at a Swedish softwood grading book will give an idea of what quality means in Europe.

Andrew Teare of the Rugby Group reviewed his company's experience in moving into wood products in the U.S. and the U.K. Rugby has established a major position in millwork distribution in the U.S.

He noted that Rugby has learned a number of lessons in the U.S. that are being applied to their own John Carr millwork manufacturing subsidiary in England.

"Growth for overseas suppliers in the U.K. will come from supplying manufacturers like ourselves with more and more specialized and specified components," he said.

"We shall build the products competitively and resist strongly import penetration by manufactured products," Teare noted.

Changing sources of supply

Supply sources traditionally relied upon in the U.K. and northern Europe are changing. Several years of losses have led to reductions in Finnish and Swedish sawmill capacity. Canada surpassed Sweden as a softwood supplier to the U.K. last year.

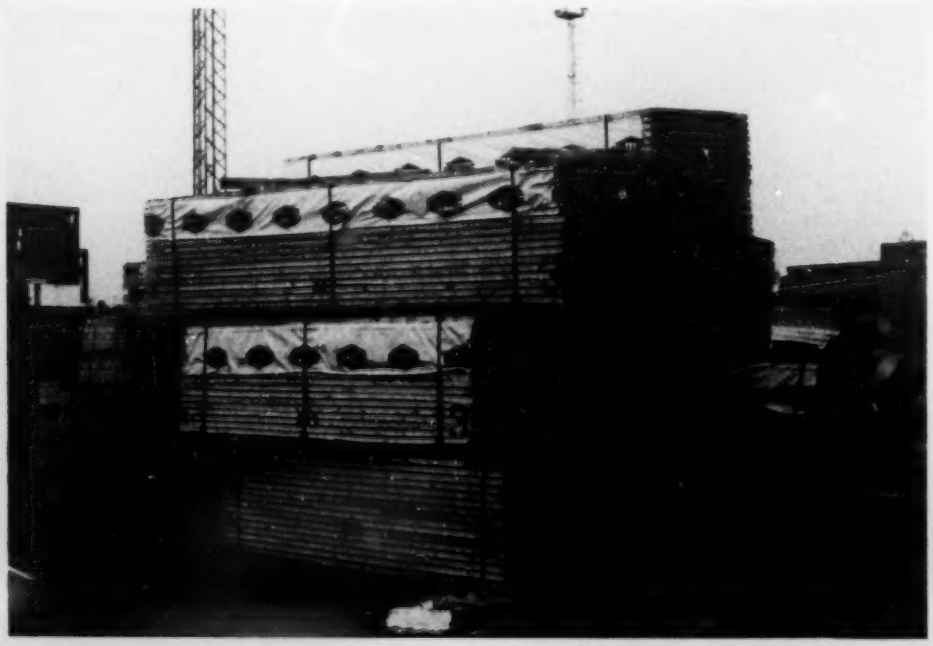
In Sweden and Finland, softwood growing stock volumes are increasing because landowners are not cutting the allowable cut, but a good deal less. This has triggered ferocious competition for timber and rising prices for logs, which are now 70% of production cost.

In some districts, paper mills are competing successfully for small sawlogs, which exacerbates the supply crunch.

The Scandinavian fiber gap that received so much press in the U.S. a decade ago has not materialized, but there has been an economic supply crunch instead. This probably accounts for the high level of interest in small landowner behavior in Scandinavian forest economics research.

An emerging source of U.K. supply is locally grown timber. Currently, the U.K. is only 16% self-sufficient in softwood sawnwood. But planting programs have produced a significant softwood resource, noted John Campbell, OBE, of the Economic Forestry Group. These plantations, which feature American conifers, are of a good age class distribution and are now yielding thinnings.

Production of softwood logs was only 2.5 million m^3 overbark in 1972, rose to



***Lumber** from North America, shown here being loaded at Tilbury docks, London. Photo courtesy of Vinland Wood Products.*

The emerging 'One Europe' has important and positive meaning for North American exporters, particularly of softwoods for construction markets. Nonetheless, Western Europe will continue to be a very competitive market

5.0 million m³ in 1987, and could reach 9 million m³ by 2002-2006. The Forestry Commission's plantings account for 80% of this amount. The increased local harvest would boost U.K. self-sufficiency in sawnwood to 29% by the year 2000. Self-sufficiency in newsprint is expected to grow from 0 in 1981 to 41% by 2000.

Principal end uses for locally grown softwoods are packaging, fencing, and mine timbers, which do not compete with imported softwood lumber. Recent years have seen new investments in sawmills, designed to improve dimensional tolerances, drying, and consumer service.

In addition, a significant increase occurred in waferboard and pulpwood markets, which is enabling an improvement in thinning regimes.

Finally, the U.K.'s principal source of tropical hardwoods, Southeast Asia, is changing dramatically. Supplies of traditionally valued hardwoods are dwindling due to cutting, land use change, and increased conservation reservations.

J. Michael Ginnings, a consultant based in Singapore, predicted that these supplies would virtually vanish by the end of the century. He observed that this fact has not been sufficiently well appreciated in the U.K. trade to date.

He also noted that many Southeast Asian governments are imposing local processing requirements to reduce log and rough lumber exports.

Ginnings expects the long-term market for Southeast Asian timber to shift to the People's Republic of China and the "Tigers"—rapidly growing nations like Singapore, Taiwan, Japan and South Korea.

The strong demand for timber and rising import prices have eroded the traditional conservatism of wood processors to some degree. There is a somewhat more open attitude toward new species.

For example, one agent is developing a market for lodgepole pine from B.C.; radiata pine from New Zealand is being promoted; and one major importer has begun stocking American oak and ash in just the past two years.

Changing rules

As ever, forest product trade will be affected by the changing rules of the game. Of greatest interest were two major European Community changes that are expected to take effect in the early 1990s.

First is a "One Europe" set of standards for sizes and grades that could substantially overcome a balkanized market of unnecessarily diverse standards. This was mentioned by several speakers as a powerful development. Also important will be a EC-wide harmonization of Value-Added Tax (VAT) provisions which could affect construction, investment and wood products demands.

These moves toward implementing postwar dreams of a single European market could provide the greatest scope for locally grown woods to contribute to future supplies. But they also will improve the ability of North American producers to serve the market.

Experts suggest that the U.K. market is likely to ban imports of green softwood lumber before long. This will require North American producers to meet U.K. standards of drying.

An EC tariff on planed wood hinders the U.S. and Canada in supplying surfaced lumber. But even within the existing rules, progress can be made.

Robert Kincaid of the U.S. softwood promotion office in London (a joint venture of the Southern Forest Products Assn. and Western Wood Products Assn.) reports that several major builders are now relying more heavily on ALS sizes in their softwood lumber buying.

Changing trade rules and stumpage charges in Canada will affect U.S./Canadian bilateral trade as well as their competiveness in Europe.

Implications for U.S. producers

From the conference and other conversations with trade participants, a few implications for U.S. producers can be drawn:

- North American hardwoods are familiar in the U.K. and are growing in popularity. They will have an edge as supplies of more familiar tropical woods dwindle. Users will more likely turn to familiar American species, rather than endure the difficulties of becoming accustomed to the "secondary" tropical species.
- The emerging "One Europe" has important and positive meaning for U.S. exporters, particularly of softwoods for construction markets. But One Europe also will benefit our competition. The Scandinavian, Russian and Eastern European suppliers are closer to the marketplace there and can be expected to move quickly to capitalize on opportunities. One Europe or not, Western Europe will continue to be a very tough market for U.S. softwoods.
- Eastern North America has an opportunity in softwoods, but only if its mills can overcome buyer concerns about reliability of supply and quality. Currently, U.K. buyers turn to the Northeast largely for green, unplaned, construction-grade timber. Will that region be able to compete in higher grades and in the value-added components described at the conference?
- Truss technology is highly sophisticated in Europe and the U.K. Southern pine producers have not failed to notice this, and are able to market their species' strength to an important niche where technical qualities are all-important.
- The high prices of West Coast specialty woods such as red cedar and of some hardwoods is selectively increasing the joinery makers' interest in softwoods. The times have never been brighter for capable specialty marketers.
- The Canadians are well established in the U.K. market; they know the opportunities, the market, and the competition well. In 1986, total U.S. softwood exports to the U.K. could have fit on a few large ships . . . for a rousing market share of 2%. Last year, with a booming domestic market, U.S. producers didn't need the business. But what about 1988, and 1998? ■

THE AUTHOR is president of The Irland Group, an Augusta, Maine, consulting firm, and president of Vinland Wood Products, a startup firm which is attempting to develop export markets for New England woods. Author of two books and 130 articles on forestry and natural resources, Irland is a registered professional forester in Maine and Faculty Associate at the College of Forest Resources, University of Maine at Orono.

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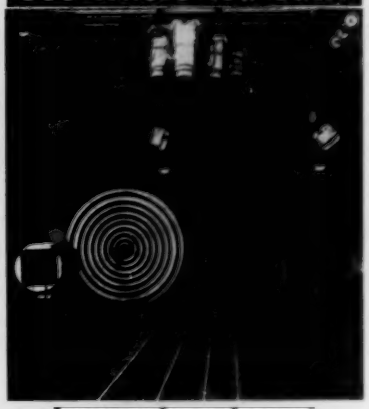

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